

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 95-0129

Sales and Use Tax

For the Period: 12/31/91 through 12/31/93

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ISSUES

I. Sales/Use Tax - Governmental Entity Exemption

Taxpayer protests the proposed assessment of sales/use tax with respect to taxpayer's activities performed under its contract with a State University.

Authority: IC 6-2.5-2-1; IC 6-2.5-4-10(a); IC 6-2.5-3-2; IC 6-2.5-5-16; 45 IAC 2.2-5-24; Indiana Waste Systems of Indiana v. Indiana Department of Revenue, 633 N.E.2d 359 (Ind. Tax 1994); Universal Group Ltd. v. Indiana Dept. of State Revenue, 642 N.E.2d 553 (Ind. Tax 1994).

II. Negligence Penalty - Imposition

Taxpayer protests the imposition of the ten percent (10%) negligence penalty.

Authority: IC 6-8.1-10-2.1(e); 45 IAC 15-11-2(c)

STATEMENT OF FACTS

Taxpayer is incorporated under the state laws of Indiana and maintains its commercial domicile in Indiana. Taxpayer operates a flight training school. Taxpayer has entered into a contract with a State University to provide flight instruction to its students. The contract terms are extensive and will be discussed in greater detail in the discussion section that follows. The university had historically billed students directly for the fees associated with taxpayer's services and flight time. However, beginning in 1982, taxpayer started billing students directly. According to

taxpayer, this change in billing was initiated to better monitor and enforce collection of student fees.

The Department assessed sales tax on the students' use of the taxpayer's planes for solo flying time. Additionally, use tax was assessed on taxpayer's use of its planes for dual flying time instruction in which an instructor employed by the taxpayer flies with the students. Taxpayer argues that it is exempt from sales and use tax with respect to its instruction and rental service provided under its contract, because the university is an instrumentality of the state.

Additional facts are separately stated under the following discussion section.

I. Sales/Use Tax - Governmental Entity Exemption

DISCUSSION

In Indiana, the sales tax "is imposed on retail transactions made in Indiana." IC 6-2.5-2-1. Additionally, IC 6-2.5-4-10(a) provides the following:

- (a) A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person.

Indiana use tax is imposed on the use of tangible personal property in Indiana. IC 6-2.5-3-2. Thus, the Department assessed sales tax on taxpayer's rental of planes to The University students and assessed use tax on the use of taxpayer's planes by its instructors flying dual airtime with University students.

Taxpayer contends that it is exempt from sales tax and use tax with respect to its activities covered in its flight instruction contract with the University under the provisions of IC 6-2.5-5-16:

Transactions involving tangible personal property, public utility commodities, and public utility service are exempt from the state gross retail tax, if the person acquiring the property, commodities, or service:

- (1) is the state of Indiana, an agency or instrumentality of the state, a political subdivision of the state, or an agency or instrumentality of a political subdivision of the state, including a county solid waste management district or a joint solid waste management district established under IC 13-9.5-2; and
- (2) predominantly uses the property, commodities, or service to perform its governmental functions.

Taxpayer contends that its location is an extension of the classroom and its employees instruct the students enrolled at the University. The Chairman of the Department of Aerospace Technology at the University is responsible for coordination of all phases of the flight program offered by taxpayer to the students. Professors monitor the program, and taxpayer's employees pass on evaluations of the students and recommendations for disenrollment of students to the students' professors. Taxpayer's instructors are required to follow course outlines, lesson plans, and hour-by-hour syllabi provided by the University. Additionally, the fees associated with the flight school are eligible for financial aid.

Sales to the state of Indiana and its instrumentalities are also covered under Regulation 45 IAC 2.2-5-24, which provides the following:

- (a) Definition: Predominantly used. Predominantly for use in the performance of a governmental function means that the property acquired will be used for more than fifty percent (50%) for the performance of a governmental function.
- (b) The state gross retail tax shall not apply to sales to the state of Indiana, its agencies and instrumentalities, all counties, townships, and municipal corporations, their respective agencies and instrumentalities, and all other state governmental entities and subdivisions of tangible personal property and public utility services and commodities predominantly for use in the performance of governmental functions.
- (c) Purchases by all state governmental agencies of tangible personal property, public utility services and commodities are exempt from the gross retail tax, provided such purchases are used predominantly in the performance of governmental functions. **This exemption applies only to those purchases which are directly invoiced to the governmental entity and paid out of government funds.**
- (d) Purchases must be predominantly for use in performance of governmental functions. Purchases of tangible personal property, public utility services and commodities by the state or subdivisions thereof are exempt from gross retail tax provided the item(s) purchased are predominantly used in the performance of governmental functions.
- (e) **Purchases must be invoiced directly to the governmental entity and paid out of governmental funds.** Purchases of tangible personal property, public utility services and commodities by the state or a subdivision thereof are exempt from gross retail tax, provided the purchases are invoiced directly to the governmental entity and paid for out of government funds. Purchases which are for use by the governmental entity, but which are not invoiced directly to the state or subdivision or are not paid for out of governmental funds, are subject to the gross retail tax.

(Emphasis added)

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Taxpayer contends that the University is acquiring its services and the use of its planes as part of its curriculum. Taxpayer argues that the provisions in the above regulation requiring that purchases be invoiced directly to the governmental entity are in conflict with the statutory authority (see IC 6-2.5-5-16, cited above). Additionally, taxpayer claims that the airplanes are predominantly used by the University students in performing its governmental function of teaching students as required by IC 6-2.5-5-16.

In summary, taxpayer is arguing that the governmental agency exemption "flows through" to taxpayer. In determining whether to extend agency or instrumentality status to a business working under contract for a government entity, the courts will look to the statutory treatment and creation of the business. Indiana Waste Systems of Indiana v. Indiana Department of State Revenue, 633 N.E.2d 359 (Ind.Tax 1994). In Indiana Waste Systems, a garbage collector asserted that it acted as an agency or instrumentality of the City of Indianapolis by virtue of its contract with the Indianapolis Board of Public Works. In its analysis, the court looked to a tort case involving volunteer fire fighters. See Ayres v. Indian Heights Volunteer Fire Dep't, Inc., 493 N.E.2d 1229 (Ind. 1986). In Ayres, the township trustee was required to provide fire protection and fulfilled his obligation by contracting with the volunteer fire department. The trustee's immunity flowed to the fire fighters because of Indiana's comprehensive statutory treatment of volunteer fire fighting. The court in Indiana Waste Systems held that the garbage collectors should not receive the benefit of the governmental exemption. The garbage collectors were not creations of Indiana statutes, but rather were private businesses available to anyone requiring their services, either public or private, and at a charge for their services.

Similarly, taxpayer is not a governmental agency or instrumentality. It is instead a private business, operating under contract with a University just as any other independent contractor. Unlike the volunteer fire department in Ayres, taxpayer is not a statutory creation. Taxpayer, not being an agency or instrumentality of a government agency, is not entitled to the government exemption.

However, the Indiana Tax Court in Universal Group Ltd. v. Indiana Dept. of State Revenue, 642 N.E.2d 553 (1994), established that taxpayers are not subject to gross income tax on income they receive in an agency capacity. The same rule would apply for sales tax in accordance with the provisions of IC 6-2.5-10-2. Therefore, when the taxpayer's planes are used for dual flying time in which an instructor flies with the student the taxpayer is acting in an agency capacity for the University. When the taxpayer's planes are used for solo flying by the students, the taxpayer is not acting in an agency capacity.

FINDING

Taxpayer's protest is denied in part and sustained in part. The taxpayer's protest is denied on the students' use of the taxpayer's planes for solo flying time. The taxpayer's protest is sustained on the use of its planes for dual flying time instruction in which an instructor employed by the taxpayer flies with the students.

II. Negligence Penalty - Imposition

DISCUSSION

Taxpayer protests the imposition of the ten percent (10%) negligence penalty. The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(c).

As the position taken by taxpayer with respect to the denied issue was not unreasonable, waiver of the negligence penalty is warranted.

FINDING

Taxpayer's protest is sustained.